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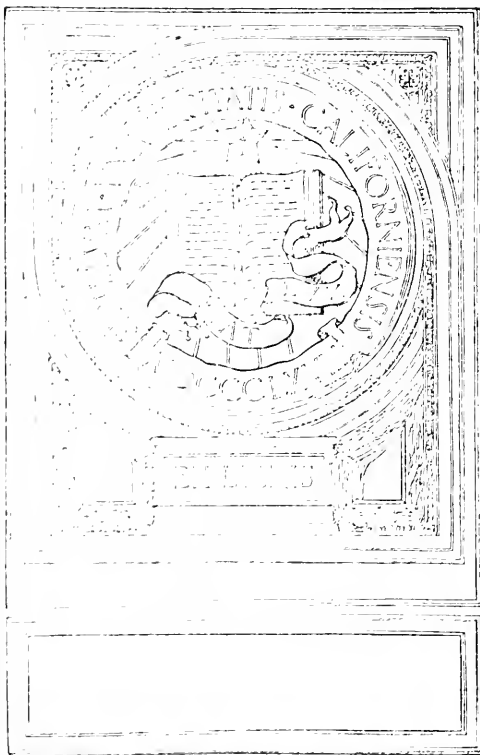


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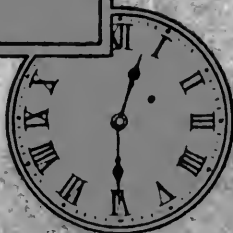
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FOR THE ODD
HALF-HOURS.

By

GEORGE W. GOUGH.

Sometime Exhibitioner of Balliol College, Oxford.

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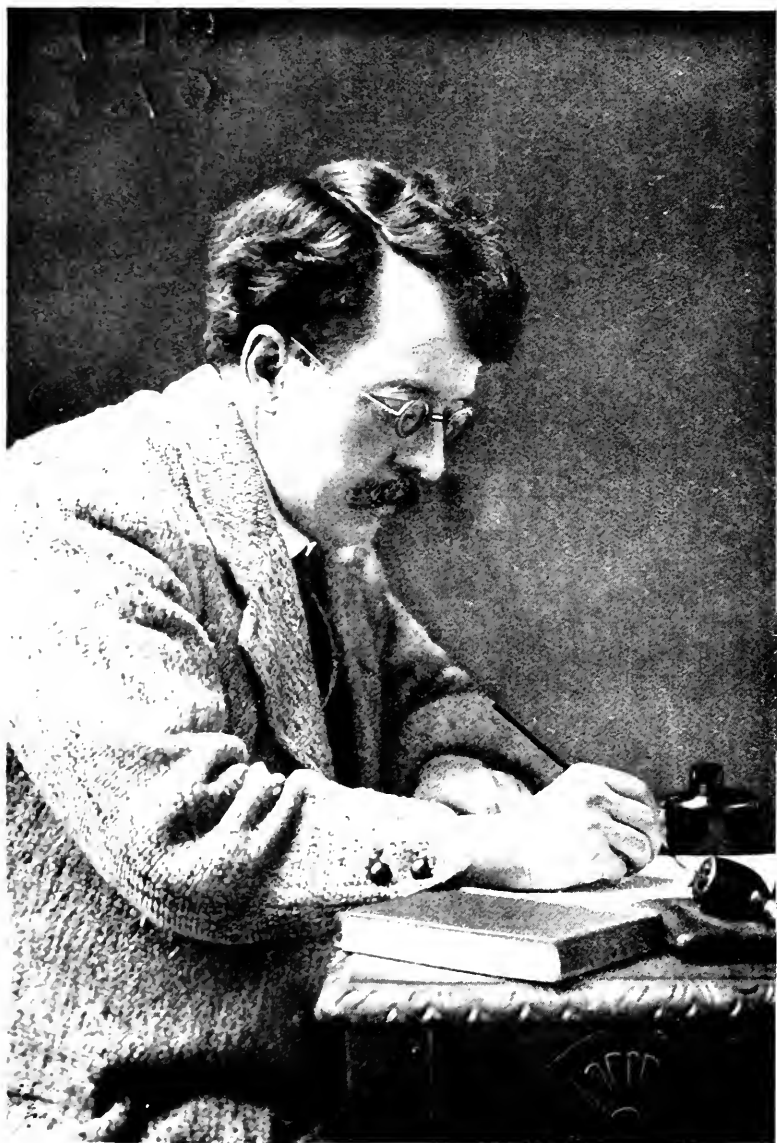
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THE author of this book is the son of a railway servant and his interest in economics was first aroused when, as a small boy, he used to walk up and down the great goods yard at Stafford with his father and got into the habit of enquiring what was in the waggons, where they came from and where they were going to. Into hundreds of waggons the small child climbed, investigating the hidden mysteries of pit props, pigs of lead, barrels of apples, etc., etc.

His first close interest in the study of economics was aroused when an old shoemaker—of the class now largely driven out by modern machinery—advised him to read Adam Smith's "Wealth of Nations." The young teacher took the advice and an interest in economics began which was destined to have wide results.

Mr. Gough went to Oxford and is proud of being "a Balliol man;" he was an Exhibitioner of the famous college and secured first-class honours in Modern History. He was Cobden prizeman, London, 1901, and Oxford University, 1905, and Brassey student for 1907. His "Ten Minutes' Talks with Workers" in *The Times Trade Supplement* have attracted world-wide interest, but his proudest work is

"THE YEOMAN ADVENTURER,"* a story as full of human pathos and splendid grit as any that has ever been told.

But Mr. Gough's greatest pride is that he is "of the people," and that he can speak to the worker as one of themselves. Knowing the trials and difficulties of working men and women he is able to throw aside the cloak of the professor and write of the realities. His short talks on the succeeding pages are as human in their touch as they are broad in their views.

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CHAPTER I.

What is Political Economy ?

IF we pick up a book on astronomy, on grammar, or arithmetic, or botany, most of us have a pretty clear notion of the kind of information it will give us. Just as men do not gather figs from thorns, so they do not expect to find information about vulgar fractions in a text-book of botany. There is, however, no such general knowledge of what is to be expected from a text-book of economics. What is even more significant, however, is this: nobody in his right senses would dream of giving an opinion on a problem in chemistry if he had never learned any chemistry, while it is quite the usual thing for people to give, off-hand and cheerily, opinions on economic problems without making any attempt by reading and observation to fit themselves for the task. Because political economy is concerned with the daily life of men, it is, of course, possible for a man to go quite right on some important economic matters by the mere force of native shrewdness and insight, especially if those matters closely concern him in his daily work. Still, it is quite clear that the study of economics is a necessary preliminary to the formation of sound views on economic questions, and as economic questions are daily becoming more and more important, it is proposed in this series of papers to help our readers to study economics for themselves. Certainly, it can be promised that they will find the subject fascinating as well as useful.

What does political economy deal with?
The easiest and perhaps the best answer is that

it is the study of daily life of man in a modern state. Every day an Englishman experiences a succession of wants. He is hungry and must have food, cold and must have firing, in the dark and must have light, in the wrong place and must get to the right one by train, tram, or 'bus, and so on indefinitely. These wants are satisfied mainly by goods or commodities, but also by services—*e.g.*, those of engine-drivers, laundresses, teachers, actors, etc. Wants and goods form the starting point of political economy.

In a modern country like England few people grow or make any of the goods they themselves use to satisfy their wants. When I need a commodity—*e.g.*, some meat or a hat—I go into a shop or market and buy it with money. A market consists of two sets of people, sellers or suppliers of goods, and buyers or demanders of goods. Our next important subject of study is, therefore, the conduct of these two classes of people, the study of the laws of supply and demand, or more shortly, the study of markets. It should be noted (1) that a market is not necessarily a separate building; there is now-a-days a world-market for some commodities—*e.g.*, wheat and cotton; and (2) that for some purposes we quite properly speak of the "labour market," although labour is not a commodity.

But we can only purchase goods in a market if we have the money the seller demands in exchange for them. The amount of money we have at our disposal during a given period is called our Income, because Incomes are estimated in money. Clearly, however, our real income for that period consists of the goods and services we have used in satisfying our wants. The distinction between real incomes and money incomes is extremely important, and must never be forgotten. Incomes are either earned or unearned—that is,

they are either the wages of labour or payments derived from allowing others to use our property. Some people, of course, draw part of this income from their labour and part from their property. The study of incomes is the next important part of economics.

Finally we are obliged to make payments to the Government, those to the King's Government being called "taxes," while those to the Local Government of the place we live in are called "rates." The study of rates and taxes, or of public finance, is one with which political economy is very closely concerned.

Goods, Markets, Incomes, and Taxes—these form the chief topics with which Political Economy concerns itself.

CHAPTER II.

The Problems and Methods of Political Economy.

HAVING indicated the general character of the subjects with which the economist concerns himself, we next proceed to ask: What is the object of his studies? What problems does he set out to solve, and what useful purpose is served by solving them?

We have seen that human needs are satisfied by goods or commodities. The mass of goods available in any national territory for satisfying the needs of its people, constitutes the wealth of the nation. The mass of goods belonging to a given individual in that nation constitutes his wealth. Again, be it carefully noted that though wealth is measured in money, money is only one part—a small and really insignificant part—of wealth. In England, for example, the coined money existing in the country does not form one-hundredth part of the total wealth. National

Wealth and Individual Wealth, National Income and Individual Income, are conceptions of first-rate importance, and each forms the basis of a great and very practical problem.

England is to-day a far wealthier country than Spain, yet in the reign of Queen Elizabeth Spain was far wealthier than England. England to-day is far wealthier than she was at the beginning of last century. Measured in money, the wealth of England in 1900 was at least seven times greater than it was in 1800. Here, then, is the first great economic problem: "Why does national wealth vary from country to country at the same time and from time to time within the same country?"

The next problem is to account for the variations in individual wealth. A very popular dancer earns more in a month than a sweated shirtmaker earns in her whole lifetime. Most of us do not own enough land to stand on: there are a few who own estates large enough to find standing room for the entire population of the earth. We want to know why these things are so, and the study of economics explains them. There was a time when these facts were accepted as part of a divine order. We sang in church on Sundays:

"The rich man in his castle,
The poor man at his gate,
God made them rich and lowly,
And ordered their estate."

We have ceased to sing nonsense about them, and are bent on getting to understand why they have come about, and it is Economics that is concerned in the inquiry.

It is the object of all science to explain, but in all sciences the process of explaining can be pushed back farther and farther until

we come to something that cannot be explained, but must be taken for granted. The explanation of many phenomena is gravity, or life, but gravity and life cannot be explained. The science of political economy is, in this respect, like other sciences, and yet unlike them.

The economy of a modern country like England rests on two ultimate bases: (1) private property and (2) competition. Any argument which assumes that these bases are not there, is, therefore, futile. A. is wealthier than B. because he owns more property than B. does, not necessarily (though, of course, very frequently) because he is a better man in any sense of the term. C. gets £100 a week for dancing because managers compete for her services; D. gets 5s. a week for making shirts because there are scores to compete for her place if she thinks the wage too small.

But though these facts—private property and competition are at present ultimate facts, to be taken for granted, the economist knows that at one time they were altogether unimportant. As far as he knows they may become unimportant again. All he says is, in effect, "Here they are now; they lead to certain results, some wholly admirable, some extremely unsatisfactory. Any sudden reversal of them is entirely out of the question. Any proposed reform, to be worth looking at, must assume their continued existence and importance."

At one end of the scale there is the "submerged tenth," at the other the "idle rich." It may safely be said that if neither class existed, the present social order would be wholly admirable. The great bulk of us, in varying degrees certainly, but without substantial injustice, do our work and get our incomes, and have a command over the material means of life which would amaze a mediæval baron in his draughty, insanitary, and uncomfortable castle.

CHAPTER III.

Important Facts about Commodities.

THE young student of economics will find it rather difficult at first to keep constantly in mind some of the simple but fundamental truths of the science. The result of failing to keep them in mind can be best seen in the foolishness of the practical proposals put forward by men who have never paid any attention to the science. Quackery is as rife in economics as it is in medicine.

Let us make quite sure from the very beginning that we understand the exact nature of commodities and their relation to human needs.

To begin with, it is necessary to observe that some of our most urgent needs are satisfied by external objects which are not commodities. The usual illustration is air, the thing we need most constantly and most acutely. Water is another urgently needed thing, but it is not a commodity amongst a small tribe of savages living on the bank of a river. The Bible tells us of a time when not even food was a commodity among the Chosen People, for manna was supplied to them gratuitously and miraculously. What, then, is a commodity in the economic sense?

Nothing can be a commodity unless it satisfies a human need—that is, unless men want it. It must possess “utility,” as the economist says, and this is its first characteristic. We have no judgment to pass on whether men ought to want it. The fact that they do want it is all that concerns us; beer and Bibles, spears and pruning hooks, are equally commodities.

In the next place, a thing, besides being useful, must be scarce before it can become a commodity. By scarcity we simply mean that there is not enough of it to go round. In the economic sense wheat is just as scarce as diamonds, though 4,000 million bushels of it are grown every year. The distinction is often put by saying that air is a "free good," and wheat an "unfree good." Both are natural products; but while Nature gives us air without effort on our part, and in such abundance that everyone can have all he wants, she only gives us wheat as the result of effort or work on our part.

In the last place, a commodity must be capable of appropriation and transference—that is, it must be the property of one person who can, if he chooses, hand it over to another. The upshot of the matter is that commodities have to be worked for. Work ranges from the picking of blackberries to the making of Dreadnoughts; from the mere appropriation of things provided by Nature ready for use to the concerted and laborious work of thousands of men of every possible grade of skill. Human labour must be exerted, and the powers and materials of Nature forced to yield us the commodities we need.

In using particular commodities to satisfy particular needs, a very important law of human nature comes into operation. The desire for further supplies of a given commodity diminishes as our stock of it increases. A housewife frequently needs tea; she never needs tons of it. As her stock of it increases pound by pound, each succeeding pound is less acutely needed, until at last she comes to a pound which she is quite uncertain whether she wants or not. Economists call this pound of tea the "marginal" pound, and its utility the "marginal" utility of tea to the particular person concerned. And its importance is very great, for it means two things: (1) If

I go on accumulating tea after this point has been reached I am making a bad mistake, for I clearly ought to be thinking now of other goods to satisfy other wants, and, therefore (2) if I am the owner of tea beyond my own margin, I shall be willing to exchange it for some other commodity in regard to which I have not yet reached my margin. Suppose it is tobacco. The man who exchanges will look at tobacco exactly as I look at tea. The fact that he will take my tea proves that he is inside the margin for tea, as I am for tobacco. At one time it was universally thought that in an exchange of goods one party must necessarily lose. We now see clearly that as a matter of fact both parties necessarily gain; it does not make the slightest difference to this mutual gain that one party to the transaction lives in England and the other in America.

CHAPTER IV.

The Production of Goods.

ADAM SMITH, the founder of the modern science of political economy, called his great work, published in 1776, the "Wealth of Nations." His view of the scope of the science is happily indicated by its title. Given a nation of so many souls, settled on a given national territory, the first thing the economist has to find out is the set of conditions and the nature of the arrangements which will make the wealth of that nation, the mass of commodities available for the use of its people, as great as possible. How the commodities when produced are divided out amongst the people

is, of course, a very important matter, but it is another and quite different matter, and must be left for treatment in the right place. The connection between the two problems is one, however, which may be stated at once, so that we can gradually work our way to a clear understanding of both. The way in which wealth when produced is shared amongst the producers has an important reaction on the amount produced. An illustration will make this clear. The wealth produced on a slave plantation was divided in such a way that the owner got for himself all that was left after he had used up just enough to keep his slaves alive and in good working form. Clearly this was a very bad arrangement for the slaves, but it looks as if it were the best arrangement that could possibly be devised from the master's point of view, since, under it, as the plantation song had it,

“De niggers make de cotton en co’n
En de w’ite folks gits de money.”

It was, however, nothing of the sort. Slave labour never pays in the long run, for it is wasteful and inefficient, and only useable at all in the lower grades of agricultural production.

Wealth is produced in a modern country by the co-operation of four factors or agents of production, divisible into two groups as follows:—

Agents or Factors of Production :

I. Two Original Factors.

1. Land and natural agents, or, in one word, Nature.
2. Labour.

II. Two Factors that have been Developed in the Evolution of Industry.

3. Capital.
4. Organisation.

Variations in national wealth are the result, therefore, of variations in the available supply of these four factors of production.

Recorded history, as we know, does not take us very far back in the economic history of the world. Comparative philology, the study of words, has taken us back perhaps thousands of years beyond the earliest scrap of written history, but even then we find our primitive ancestors, the so-called Aryans, already in a pretty advanced stage of economic development. Geology, perhaps, does show us very dimly the original man almost naked in the face of natural forces he could hardly use, much less control. Here we have the beginnings of economic life, the union of the two original agents of production, land and labour. Even so far back, however, he had made some little attempt to provide himself with tools to help him—a stone hammer, a flint spear-head, bone fish-hooks, and so on. That is, he had begun to accumulate capital, and beyond any doubt there were the rude beginning of organisation, constantly between members of the same group, occasionally between members of different groups. Even in the rudest hunting, two men co-operating, one to drive the game where the other can hit it with a spear, get in the long run more than twice as much as both acting singly. Then, when the greatest of all discoveries was made—namely, that it was possible and much more profitable to catch animals rather than kill them—the upward economic movement was fairly started.

The study of these four agents of production is very important. One truth, often lost sight of in all sorts of proposals, is that in the long run improvements in social conditions have got to be based on improvement in the agents of production. If the reader is considering any such suggestion (*e.g.*, to tax imported goods, or to introduce the "single tax") he should at any rate start by thinking out its relation to production, for the first interest we all have is in maximising the amount of wealth produced.

CHAPTER V.

The Division of Labour.

THERE are two features of our every-day life to which we are so accustomed that we hardly notice them, though they are very well worth attention in themselves, and the explanation of them is one of the principal tasks of economics. The first is that practically nobody produces any of the goods which he himself consumes. A baker may of course eat some of his own bread, and workmen very often have gardens or allotments in which they grow vegetables for their own use, but these and all similar exceptions are really quite unimportant. The town of Burnley, for example, does not consume enough of its own products to keep one of its looms at work. The second of the features which we are now examining is that practically nobody produces the whole of a given commodity. The man who can make a shoe from start to finish has become almost as rare as a white blackbird. The lady who could make her own clothes from start to finish is as extinct as the dodo. Yet Mr. Croaker, in Oliver Goldsmith's play, "The Good Natured Man" (written in 1768), says, "I have seen a lady clothed from top to toe in her own manufactures formerly"—that is, she was wearing clothes which, from the wool onwards, had been made in her own household. The rule is that a modern worker makes a small part of a completed article which he never uses himself, or which at most only forms a small part of his total consumption, which in the main consists of articles produced by other workers, often living in other countries. Economists speak of this phenomenon as the

"Division of Labour," a rather absurd term in itself. The process really consists of the separation of tasks and the union of labour, to fit the tasks into one another.

The advantages of this Division of Labour are quite obvious. It increases the skill of the worker, and so makes his output greater. It facilitates the use of tools by restricting the number of different tools which a workman requires. It makes him more dextrous in the use of those he does use. It leads to the introduction of machinery, for as soon as a task becomes mechanical it is very likely that a machine can be made to do it. It allows every worker to find work which suits his capacity; a man who would be useless if he had to make the whole of a shoe, may yet earn a good living at making the heels, and so on. The result is that the aggregate output of a given number of workers is increased enormously beyond what they could accomplish working separately.

And the process is continually being extended. The number of different employments recorded in successive censuses increases rapidly. For special classes of workers Division of Labour may be injurious for a time, as the invention of machinery which will take over their simple tasks throws some of them out of work. Then they are at the further disadvantage that there is a much smaller market for the only kind of work they can do. It is doubtless true, too, that work is becoming more mechanical, and the worker consequently a mere automaton. He repeats the same simple task, hour after hour, day after day, until days grow to years and the years to a lifetime. We cannot do what William Morris and John Ruskin desired, for a return all round to craftsmanship and artistry in work is impossible. The evil undoubtedly exists, and the remedy is to train and equip the younger generation to enjoy a fuller and

nobler life outside the factory and the mill, and to provide them with the means of doing it.

The extent to which Division of Labour can be carried is limited by the extent of the market for the complete finished goods. We see the connection of the two when we observe that the minute sub-division which is now the rule has gone on while our exports have been increasing by leaps and bounds. The making of men's clothing affords a striking example, for while there are still tailors in a small way who measure customers for a complete suit and make all of it themselves, the making of a complete suit in a large ready-made clothing factory in Leeds is divided among scores of different hands.

One other result of Division of Labour is that the production of goods is carried on for an unknown market. The village tailor only makes his suit when a definite customer has given an order. The Leeds manufacturer turns out thousands of suits every week without having the slightest knowledge of the whereabouts of the people who will buy them in order to wear them. Of course, the heads of these large firms have to know pretty exactly what they are doing, and the successful ones do not make any vital mistakes, but clearly there is a danger, taking industry as a whole, that the right kinds and the right quantities of goods may not be turned out. When this happens on a large scale it may cause grave trouble, and is often a contributory cause of an industrial crisis.

The last point to which attention must be called is the intimate connection between Division of Labour and the Growth of Capital. Capital makes large-scale production possible, and large-scale production makes further sub-division of labour profitable. Profitable to whom? To everybody concerned, and not least of all to the workers. The worker thinks,

rightly enough, that his own immediate interest is in the amount of money wages that he earns, but his interest in the quantity of goods produced is just as direct, though, perhaps not as plain to him, unless he trains himself to see economic laws actually at work. If the amount of wealth produced increases, there is at least a chance that the share of the workers will increase, and by combination amongst themselves they will be able to get that part of the increase to which on economic grounds they are entitled.

CHAPTER VI.

Capital : (1) What It Is.

IT is clear, then, that we are, as it were, going to market, but on the way there we are occupied in finding out why it is that national wealth varies from time to time and country to country. Two causes of variation we have touched on: (1) The size of the national territory, and the way in which Nature has endowed it with fertility and minerals (especially coal and iron), rivers and harbours, and so on; and (2) the extent to which its people have carried out the Division of Labour. We said, too, that there was an intimate connection between Division of Labour and Capital, the third factor in wealth production. All other things being equal as between two nations, the one with most and best capital will forge ahead of the other.

What is Capital? This looks an easy question, surely, but as a matter of fact there has been more dispute among economists over it than over any other question. Its importance may be seen from a simple fact: Karl

Marx, the founder of modern Socialism, explained his views in characteristic German fashion in three large volumes, the well-known title of which is simply "Capital." He hoped to revolutionise society, and to do so, he says in effect, we must thoroughly understand Capital. We are at work on a much less ambitious project—to understand society, not to revolutionise it; but we must do as Marx did, and try to understand Capital.

It will help us to go right if we set down right away the points that are disputed about. There is no space to discuss them; indeed, we shall often and purposely start hares in the hope that readers will hunt them. The older economists drew clear-cut distinctions (1) between Wealth and Capital and (2) between Land and Capital. Some modern economists refuse to draw one or both of these distinctions. It really does not matter as much as you might think which side is taken, but it is useful to worry the matter out for yourselves.

The best way to do this is to start with a clear and definite understanding that Capital is not money. The stupidities that follow from supposing that it is are pretty familiar. For example, we are told quite truly that millions of capital are flying abroad. What goes abroad when this happens? Millions of sovereigns? We have sent enough capital abroad in a year to clear every gold coin out of the country if this is really the case, and as our stock of gold rapidly increases through it all, it is obvious that whatever else happens when capital goes abroad, the money stops at home.

There are two ways of looking at capital:

- (1) From the point of view of its owner, and
- (2) from the social point of view.

(1) Capital from the private point of view: The capital of a business is the estimated cash value of everything the firm owns—

its land or leases, its buildings, its machinery, its stock of raw materials and finished goods, its goodwill, its book debts, its patent rights, its cash in hand, and so on. It may be equal to, less than, or more than the capital originally invested in the business. It is, in short, the mass of valuable things (or titles to valuable things) which the concern uses for the purpose of carrying on its business. Capital and business are, then, connected terms; all these things are wealth, but wealth used for a special purpose—business, the end of which is profits.

(2) Capital from the social point of view: If we look at the commodities around us, we see at once that they fall into two classes. Steel is a useful and valuable commodity, but if anyone dumped a ton of it on my lawn with the idea that he was rendering me a service, I should vigorously undeceive him. A pound of tobacco on my study table—that's quite a different matter. In other words, there are commodities which are ready for satisfying a human want, and commodities which are not so ready. The tobacco is ready; the steel will be when it is a bicycle.

The two points of view coincide, for clearly the second class ("production goods") are found only in business life. The proper place for a ton of steel is a factory.

CHAPTER VII.

Capital: (2) What It Does.

CAPITAL assists labour; it is really a tool, which makes the result of a given amount of human exertion greater than it would otherwise be. It is possible to catch a fish by tickling it with the bare hand, and

half a dozen energetic men skilled at the job might catch a meal or two of fish in a day. The same men, with a steam trawler and all modern appliances, may well catch enough fish in a day to provision a small town. The labour is little if any harder, but the result is increased immeasurably. The earliest known man used bone fish-hooks; we find them side by side with the fragments of his own skeleton. Fish-hooks and trawlers are capital: they increase the product of labour. By themselves they can of course do nothing: the bone hooks have caught no fish since their owner died, perhaps scores of thousands of years ago. But it is also just as true that men without capital can do practically nothing. If all the capital in England were whirled skyward during the night, industry on the morrow would come to a dead stop.

The next step before us is to inquire how it comes about that Capital increases the productivity of labour?

(1) In the first place it enables industry to be continuous. If the tanner had to catch and flay the animals whose skins he wants, he would do very little tanning. In one of the largest tanyards in Europe the writer saw hundreds of thousands of skins piled up in warehouses, and in one of the largest shoe factories in England he saw a few days later a huge basement packed with leather of every kind, much of it from the tanyard nine hundred miles away. The modern worker has at hand a continuous supply of everything he wants, time is economised, and industry kept going continuously. For example, the shoe factory in question, employing well over a thousand people, had had but one day's short time in twenty years.

(2) In the second place, Capital enables the processes of industry to be spread out over the length of time which will ensure the maximum output in goods in return for a given

output in labour. When the Roman poet Horace had completed a volume of poems, the manuscript was handed to a "publisher," who had it dictated line by line to a large number of slaves. It was a much quicker way of doing the thing than we have to-day. A printing establishment takes a long time to build and equip, but once there, it can turn out an edition of the whole of Horace in a day, that would have kept all the writing-slaves of Rome busy for a year or two, with the further advantage that the copies are all alike. For centuries packhorses crawled over the Alps; Capital at last made railway tunnels through them. It is probably no exaggeration to say that the trains would carry more goods through the Alps in a week than packhorses have carried over them since Rome was first built. Capital, then, enables industry to adopt long and roundabout methods with object of maximising the final output.

The older economists exercised themselves to find out how Capital originated and grows. Mill said in one famous paragraph that Capital was "saved," and in the next that it was "consumed." We need not bother about the matter here except to say that a man who "saved" a bale of cotton or one of Platt's spinning frames (both typical pieces of Capital) would simply make an ass of himself. The idea, of course, was to find a justification for the taking of interest on Capital, interest being the "reward for abstinence," as presumably, the man who "saved" the spinning frame could have eaten it had he chosen.

The quantity of goods ready for satisfying human needs steadily increases, first because the number of human beings steadily increases, and secondly because they are continually developing new wants (*e.g.*, for moving pictures, motor cars, safety razors,

and prepared breakfast dishes), and the available Capital increases because it is an indispensable factor in supplying these wants. If for any reason the demand for finished goods decreased permanently, the amount of Capital would decrease permanently. If the "saving" theory is correct, the maximum output would be saved if nobody consumed anything, and then we should all be dead in a week.

Working men are sometimes told that capitalism is *the* enemy of the working classes. Two points, however, clearly arise from our study of capital:—

(1) You cannot have capital without the capitalist to save it, and it is absurd to suppose that men will provide capital unless the ordinary motive for providing it, the profits which it earns, is assured to them.

(2) While it is true that capital earns an income for the capitalist who owns it, it is also true that it enormously increases the wages of the labourer.

CHAPTER VIII.

THE ORGANISATION OF INDUSTRY.

(1) The Industrial Revolution.

LABOUR and Capital depend for their efficiency not only on the quantity and quality of each that is available at any given moment, but on the way in which they are organised to carry on the work of production. The best way of grasping the importance of organisation as a factor in national industry is to trace its development. It will be sufficient for our purposes to go back a comparatively short distance. It would be possible, I imagine, to find in Lancashire now men who

have had personal relations with men who saw Lancashire lead the world out of mediævalism in industry into the full light and splendour of the modern world. A clear-headed man of ninety, who, as a boy of fifteen talked intelligently with a preceding clear-headed man of ninety, would not need to go to books to learn of this mighty change.

What would such a man have to think away from the Lancashire of to-day in order to reproduce the earlier Lancashire which his ancient friend had described to him from personal recollection? Just everything that makes Lancashire what it is, the most important industrial area on the face of the earth. Railways, tramways, canals, mills, sheds, works, and mines must all go; mighty towns must be reduced to drowsy villages, thriving haunts of industry blotted out altogether, docks diminished to the size of a cricket field, ships attenuated till they would be small enough to float in the swimming bath of the most modern liner. And then, what has he to think back into Lancashire to make the picture perfect? The industrial system then prevailing is known as the "domestic system." Our earlier old man would have read with delight as a boy a great novel then recently published, "Humphrey Clinker." We to-day, wonder perhaps, what Mistress Tabitha Bramble, who is on a tour through Bath and London to Edinburgh, means by her constant injunctions to the house-keeper at home to keep the maids spinning. It was the domestic system of spinning yarn under which she lived, and the village weaver would call for the yarn and weave it into cloth on the loom in his cottage. The resulting flannel Mrs. Bramble would send on a packhorse to a fair to be sold to a dealer. And this rough textile industry was so carried on in every village in the land, and though in a few districts (around Norwich, Leeds and Man-

chester) much more was done than elsewhere, it was all done in the same way—on spinning wheels and wooden looms in the homes of the people. Now a good weaver could keep three or four women at work spinning. The result was a constant dearth of yarn. Men set to work on finding some means of spinning automatically. Hargreaves made his "spinning jenny," Arkwright his roller frame, Crompton combined them in the "mule"; this outclassed the weavers, and Cartwright equated matters with his power loom. The "mills" crowded out every possible yard of riverside power, and Watts put that right by driving them by his steam engines. The goods choked the roads, and Brindley made his canal; the canal got hopelessly inadequate, and Stephenson made his railway. A little later on an antiquated fiscal system once more blocked Lancashire's further expansion, and Peel and Gladstone came to her aid and gave her Free Trade. It all happened in an incredibly short time, and in half a century Lancashire became what she is to-day, though she still, fortunately, keeps her unique power of forging ahead of every imitator and competitor in the world.

Such is a rapid thumb-nail sketch of the industrial Revolution, which gave the world the capitalist-factory system of industry. Industry had been carried by men working on their own account, or for a master not far removed in economic status from them, or in cottages and workshops, with tools so inexpensive that a poor man could afford them, with no machines (which are simply power-driven tools), with small and intermittent supplies of raw materials, and for known and mostly local markets. The Industrial Revolution replaced this system by large factories, filled with machinery and power-houses, and costing scores of thousands of pounds to build and equip, and employing hundreds and even

thousands of men and women, working for an employer whose market was steadily becoming world-wide.

CHAPTER IX.

ORGANISATION.

(2) The Prevailing Type of Industrial Organisation.

THE economic life of England is so full and complicated that success in the study of it depends on the power to break it up in imagination into simple and easily-handled problems. The economist is obliged to adopt several devices in order to achieve this end. One of these is to strip off all the complications of real life and try to get at the root of the matter by studying it in simple and indeed sometimes imaginary forms. Another device is to study a typical case, and then, what is true of this will be true of others, with any necessary changes in the results due to differences between the cases.

In selecting the type to be studied, it is of course necessary to select the most important—the type to which industry is steadily conforming more and more generally. Now, just as under the Domestic System (described in the last article) the workman owned his own tools, so under the new system in its earlier stages “the firm” owned its own Capital. To-day the tendency is for industry to be carried on by means of borrowed capital. Few people, for example, know the exact meaning of the “deposits” which appear among the accounts of our banks. When a worker “deposits” a sovereign in the Post Office Savings Bank he

hands an actual coin over the counter, but bank "deposits" are not all like this. They consist in part of money lent to the bank, but also of credit given by the bank. A man wanting to start or extend a business gets credit from his banker, who "deposits" against his name in the books of the bank an entirely imaginary sum, on which the man draws cheques in payment of his business expenses. The bank does not own the money and lend it to the man—that is not at all what happens.

Important as these bankers' deposits (and "overdrafts," which serve the same purpose) are in business, the use of borrowed capital is best seen in the case of Limited Liability Companies. Advertisements appear in the papers every day inviting the public to take up shares in companies formed for an infinite variety of purposes—to build a new railway in the Argentine, to plant rubber in Brazil or make it in London, to develop real estate in the Middle West of Canada, and so on, and the combined capital of these companies amounts to hundreds of millions of pounds sterling.

There are, as we have seen, four agents of production—Land, Labour, Capital and Organisation. We shall make the assumption that each of these agents is the property of, or is applied by, a distinct class in the community. A man (or a small group of men) with the experience, knowledge, and power necessary to organise a business, may be regarded as:—

- (1) Acquiring land, for which he agrees to pay a given rent.
- (2) Borrowing capital, for which he agrees to pay a given rate of interest. This capital, we repeat, will be simply a credit at his bank; power, that is, to draw cheques on the bank to buy the real capital required — that is, buildings, machines, tools, raw materials, etc.

- (3) Hiring workers, to whom he agrees to pay a stated rate of wages.

Having made these arrangements, he organises the business, turns out its finished product, puts it on the market, gets the highest price he can for it, and from the receipts, after allowing for depreciation and the accumulation of a reserve, he pays the rent of his land, the interest on his capital, the wages of his workers, and keeps for himself anything he has left as his profits.

It is usual to call such a man an Entrepreneur, a French word, meaning "one who undertakes to do a thing." We have not a suitable English word, for "undertaker" is used in a special and quite different sense, and the fine Elizabethian word "adventurer," used of the merchants who "ventured trade abroad," has got degraded in meaning.

The producers of wealth are thus divided in four classes, each receiving a share of the product:—

- (1) Landlords, receiving Rent.
- (2) Capitalists, receiving Interest.
- (3) Workers, receiving Wages.
- (4) Entrepreneurs, or Employers receiving Profits.

In actual life, of course, a man may be in two or three classes. The head of a firm may own all its capital, then he is both (2) and (4); a landlord may hold shares in a business, and so be (1) and (2); a worker may own a piece of land and also receive bonuses on his life assurance policy or dividends on his shares in the "co-op.," then he is (1), (2) and (3). But the only possible thing for the economist to do is to regard them as distinct and study them separately.

CHAPTER X.

The Selling of Goods.

WHEN a stock of commodities is accumulating on my hands, there sooner or later comes a time when I get to the marginal unit (see the third chapter), and I am prepared to exchange this for another article which will yield me the same utility along another line of satisfaction. Suppose this second commodity is money; then I am willing to sell my marginal unit (say my marginal pound of tea) for, say, 2s. Clearly, however, as all the pounds of tea are alike, it is a matter of indifference which one the purchaser takes. Conversely, if I were buying tea from a stock this is the price I should be willing to pay for it. This is, in brief, what the economist means when he says that marginal utility fixes price. Commodities like tea, are bought and sold in large quantities, and, theoretically, each buyer and each seller has his own marginal price, but of course in practice the marginal valuations coincide pretty closely when great masses of consumers are taken into account, and then are gradually brought together by the working of the market. I may, for example, have fixed on 1s. 11½d. as my marginal price for tea, but this is useless in a world in which the retail prices of tea always move (so far as I have seen) in twopences. I shall have to lose ½d. by buying at 2s., as it is wholly improbable that the shop-keeper will consent to lose 1½d. by selling at 1s. 10d.

When our entrepreneur has made his goods, he places them on the market. But he can never be sure what he will get for them;

even if it is usual for him to make by contract, he never knows exactly what he can be sure of getting as the contract price. The actual price is determined by the conditions prevailing at the time of marketing the goods or making the contract. Prices in retail shops and markets move slowly, but in a wholesale market much more rapidly. For example, the price of a 4 lb. loaf does not change very often, while the price of a quarter of wheat varies frequently within narrow limits. These variations, we say, are due to variations in supply and demand. Many buyers and few sellers, up prices go, fewer buyers, more sellers, they begin to fall; few buyers and many sellers, and they come down with a run. On the big world markets the movements are much influenced by speculative buyers and sellers. A man will quite commonly order 10,000 bushels of wheat who would be in a hopeless position if the wheat were brought to his door for delivery, since he can neither pay for it nor store it. No, he was dealing not in wheat but in "futures"—that is, the future price of wheat, but his dealings influence prices for millers who want the corn to grind.

If our entrepreneur does not get the price he expected, he begins to consider his position, and if he is disappointed time after time throughout a considerable period, he soon ceases to produce goods. That is to say, behind the laws of supply and demand which fix the market price on a given day for a given transaction, there is another force at work to fix prices in the long run. I have said that the entrepreneur has a price in his mind which he "expects." If the ups and downs of market prices, taking one year with another, average out with this expected price, he goes on producing. What, then, determines this "expected" price—the "natural," or "normal," or "long-period" price, as it is variously called?

We have seen that the entrepreneur has to make certain payments out of the price he receives for his goods, and that these payments form the shares of the other three agents of production. Generally, too, the amount of these shares is fixed in advance, by comparison with what the agents get in other similar industrial concerns: the trade union rate of wages, the usual interest on debentures, and so on. Over and above these, he wants something for himself, at least as much—and rather more to cover his risk—as he could get by doing similar work as the paid manager of another firm. All these expenses of production must, in the long run and on the average, be met out of the price received for the goods. In the words of the economist: market price is determined by supply and demand; normal price by cost of production. Market price may never coincide with normal price, but be perpetually oscillating about it.

CHAPTER XI.

The Rent of Land.

A rent is the payment made to the owner of a piece of land by the cultivator. It is also commonly used for the payment of the use of a house, but this includes not only the rent of the land on which the house stands, but also a payment for the use of the building. We must think of them apart, for the payments are fixed in different ways. It is best to begin with the rent of agricultural land.

Let us suppose that there are three farms, all devoted exclusively to corn growing, exactly equal in size, equi-distant from their

common market and with equal facilities of transport to it, stocked and treated in the same way, employing the same number of workers at the same weekly wage, under farmers of about equal ability.

Look at the matter from the entrepreneur's point of view, the entrepreneur here being, of course, the farmer. He has sunk capital in his farm; he wants the same interest on it as he could have got in an equally safe investment elsewhere. He pays wages; he wants them back. He has all sorts of outgoings for seed, manures, repairs; he wants these back. His dead capital depreciates, and he wants back each year the amount by which it has depreciated. He works himself, and for this he wants an amount at least equal to what he could earn as the servant of an employer. If he gets all these he is satisfied, and must be satisfied, for in the long run he can get no more.

Let us further suppose that on each farm all these required sums can be met from a yield of 10,000 bushels of corn. It is extremely unlikely that the yield of the farms will be alike, and consequently we can fix on any arbitrary but reasonable numbers: let us say, then, the first farm yields 10,000 bushels, the second 11,000 bushels, and the third 12,000 bushels.

Now we have carefully made all the factors of production that can be controlled by human foresight exactly equal for each of the three farms. Yet nobody expects these equal sets of factors to produce equal results. And why? Because the final result in farming is affected by a factor which man cannot control—the natural advantages of the soil. The difference in the results is due to nature. No doubt, the first farm could be made to yield 11,000 bushels like the second, probably even 12,000 like the third, but—and here comes the important point—not by the same amount and

kind of treatment. Let the first farmer increase his expenditure and he can increase his crop, but all other factors being equal as between the farms, Nature gives unequal results.

It is easy to draw the inevitable conclusion. If the three farmers own their own land, each of them takes the total crop; but if the farms belong to a landlord, what then? The third must yield up 2,000 bushels to his landlord, and the second 1,000 bushels. There is no injustice to the farmers in this, for even so each gets back every grain of corn he has any economic right to get back. It is rather a pity, of course, that the land has got into private ownership, for if it were all state-owned, the state would get the 3,000 bushels, and the "single-taxers," of whom we are now hearing so much, propose to take them for the State. At present they quite rightly go to the man who owns the land. From the first farmer the landlord will get nothing, because there is nothing left over for him to take. It is "no rent land" on the margin of cultivation.

Suppose we now turn the corn into money at 5s. a bushel, and observe two very important inferences. First, the fact that rent is paid does not affect the price of corn, which is 5s. a bushel just the same whether the land pays rent or not. Abolish rent, and you benefit not the consumer but the farmers of the better-class lands. Second, raise corn in price by means of an import duty, and you benefit neither farmers nor labourers, but only the landlords. When corn is 5s. a bushel, the first farmer can pay no rent; make it more he can, and the landlord can be depended on to make him. The last German tariff raised the value of the agricultural land of Germany by no less than £1,000,000,000—a pretty present to a favoured class!

Finally, we note that we are arguing from a case of farms supplying the same market.

There is, then, bound to be no-rent land somewhere (a hare the reader should hunt for himself), but it may be anywhere on the earth for a Free Trade country—say 1,000 miles west of Winnipeg.

CHAPTER XII.

The Wages of Labour.

THE wages of bricklayers in Manchester before the war were 10d. per hour. If the economist is asked to explain why they were 10d. and not 11d. or 9d., he is asked to solve what is at once one of the most difficult problems in economics, and one of the most important problems in social life. For the man who would not like them to be 11d., or even 1s. 11d., providing it could be managed, is not worth arguing with. One thing we may be sure of is that the wages are what they are neither by chance nor accident, but as the result of some law or laws. For we see law at work the moment we seriously attend to the matter. Bricklayers' wages are always higher in big towns than in small towns, are always higher than the wages of bricklayers' labourers, are always lower than the wages of foremen bricklayers, and so on. To endeavour to throw some light on the subject in one short chapter is a desperate venture, for every paragraph could be easily expanded into a long chapter.

Let us begin again with the entrepreneur, for though we may or may not like the "boss" of our work-a-day life, as students of economics, he is of essential importance to us. And, as hinted previously (beginning of Article IX.), we must adopt the device of

simplifying matters even if at first the result seems unreal. We shall merely ask the reader to assume (1) that a certain entrepreneur has at his disposal a certain amount of capital (a factory of given size and equipment); (2) that all labourers he employs are exactly alike as labourers, and one being just as good for his purposes as any other; and (3) that he agrees before starting to pay them all 30s. a week wages.

Now, as he takes on man after man, the product turned out increases rapidly, for as long as he has no men his factory stands idle. Now what extremely nice problem must the boss work out if he is to run his factory so as to get the best possible results? Clearly to produce the maximum quantity of product that pays under the limits forced upon him (which are: (1) so much capital and no more; (2) 30s. per man per week wages and no less). With no men there is no product; with, say, 1,000 men, still no product, for 1,000 men would jam his factory so full that nobody could do any work. He, therefore, puts on man after man, and watches how much the last man adds to the total product. He is clearly working his way towards a margin (an idea now getting familiar to us), and of course he stops as soon as he gets to the man whose work for a week only increases the value of the output of the factory by 30s. Here, then, is our first glimpse of the law of wages. In a perfectly run factory the wages of all workers of a given grade equal the output of the marginal worker of that grade.

We now have to ask what are the forces that shift the margin about and so help to determine wages. It is clearly useless, in the manner of the older books, to attempt to find some one determining factor. We can find the limits within which it shifts, and enumerate the forces that shift it, and that is all we can do. We may distinguish two sets of

forces at work to fix the margin: (1) Those wielded by or closely affecting the workers, and (2) those wielded by or closely affecting the employers.

(1) Wages cannot fall lower than the amount necessary to keep the labourer alive and efficient; too low wages are suicidal even from the employer's point of view. They do not in practice fall lower than is required to enable the labourers to maintain the standard of comfort to which they are accustomed. The wages to be paid were, as we have said, agreed on in advance, and in making the agreement something will depend on the current state of the labour "market," and on the relative bargaining power of master and men, and the bargaining power of the men will be enormously increased if they belong to a Trade Union and bargain as a body. The social estimation in which the work stands enters into the account, and in particular the time and money required to educate young people to follow the trade. The efficiency of the workers is of the utmost importance, for a small number of efficient workers is required to wring the last ounce of product out of the fixed stock of capital we are taking for granted, and therefore the marginal man comes earlier and the wages of all the men could be made correspondingly higher.

(2) The employer knows this as well as his men know it, and when he agrees on 30s. as the rate of pay, he knows pretty well (and we assume him to know with minute accuracy) that when he has his total working staff, up to and including the marginal man, the whole concern will be doing the most and best and cheapest work it is capable of. If, for example, he found that the working staff, as determined in numbers by the marginal man, was not big enough fully to utilise the existing capital, he would insist, if he could, on lowering wages, so that more men could be brought

in. If he could not get his way, he would be working at a loss, and ultimately be forced to stop altogether.

But the chief thing that limits him is the value the public sets on each unit of the product he is turning out, and this is closely dependent on its social utility. If its price goes up, he can sell the product of the marginal man for more money and so raise wages all round. Hence we see the economic importance of the sliding scale of wages which the workers in some trades have been able to insist on.

CHAPTER XIII.

Wages in Relation to Output.

ONE of the most important results of the Great War has been that it has thrust on us the study of Political Economy as the only possible means by which the people of a great industrial nation can fight their way through the mass of economic problems which the war brought in its train. Never was it more necessary that the conduct of each one of us, both as worker and citizen, should be right conduct because it has been based on accurate thinking. The course of wages during the war is one of the most important, as it certainly is one of the most interesting, of the economic questions thus raised.

War is waste. The Great War was waste written in gigantic letters. Consider the salient features:—(1) For nearly five years, millions of men who, but for the war, would have been engaged in producing and merchandising goods did none of this work, with the result that what they would have produced went unproduced; nay, worse than that, not

only did they not produce goods but they spent the whole of their time blowing to pieces goods that had already been produced. (2) Many other millions, both of men and women, spent their time in producing, not, as usual, goods for use in civil life but goods to be used in the war. In the war zones, the wreck of civilisation on its material side will be visible for decades to come, try as hard as we may to obliterate its traces. All over the world, for years to come, there will be gaps in our supplies of all the necessities of life because of the reduction of output during the war.

As soon as war broke out prices began to rise (1) because men who held stocks of goods, anticipating scarcity in the near future, began to put up prices (2) because the supply of goods at once began to fall off (3) because the government demand for certain classes of goods put up their prices, and the prices of all other commodities began to rise in sympathy, as the economists say, and (4) because governments were compelled to finance the war by the creation of "paper," and the inflation of the currency at once told on the level of prices.

Therefore, working men soon got into a vicious circle. The cost of living increased. To meet it they demanded higher wages, and got them. In order to pay the higher wages manufacturers put up their prices. Then the workers, finding that their increased wages were swallowed up in higher prices, demanded higher wages, and got them, and thus started travelling round the circle again. It is probably true that, taking the working classes of this country as a whole, they got a higher "real wage," by which is meant that the supply of goods coming into their homes was larger, during the war than ever before it; but it is also quite clear that this real wage has risen not very much, while their money wage, paid in "Bradburys," has about doubled on the average.

This compels us to face this question: "How can the working classes of this country increase their *real* wages?"

Let us begin by considering the question in a large and general way. The goods which flow day by day into all the working-class homes in this country are part, a large part, but still only a part, of the total mass of goods produced. Now it is clear enough that one way of increasing real wages is to increase the main stream of goods. Large rivers, as they near the sea, quite commonly divide into two streams, thus making what the geography books call a delta. Suppose that owing to a heavy rainfall in the upper country the main stream rises. When the flood water gets to the point where the delta begins, is it not quite clear that part of the excess water will flow along each arm of the delta? Apply the illustration. Consider the supply of goods as a river, fed from innumerable springs and rivulets (that is, from our farms, workshops, mills, factories and shipyards) and dividing at a certain point into two main channels, one flowing into the homes of the workers, the other flowing into the homes of the non-workers. Whatever causes the supply of goods in the main river of trade to get larger will increase that particular channel which flows into the workers' home. Moreover, this would be the case even if the workers themselves did nothing to increase the supply. If the workers contribute to increase the supply, it naturally follows that their share of it will increase even more abundantly.

This is why we hear so much to-day of the demand for increased production, a bigger output from every producing unit, however small or however large, in the whole country.

Having taken this general view, which, to borrow another illustration from geography, is like looking at a small scale but clear map of our country as a whole, let us look at a large

scale map of one particular bit of it. Take the factory in which you yourself work. The world's hunger for goods is so great, owing to the war, that every article your factory turns out is sure of a market. There are large factories in England to-day already booked up with orders for two years ahead, and manufacturers can get almost any price they like for goods ready for immediate delivery. Your employer will only be too anxious for the output of his factory to be increased, and if it is increased by extra efforts on your part, economic forces will give you full value in goods for every increased ounce of effort you put into the job.

Again, every extra article turned out by your factory will be bought by somebody who can only pay for it by turning out articles of his own. Every working man who increases his output puts into operation a set of economic forces which inevitably provide another working man with an opportunity of increasing his.

CHAPTER XIV.

Investment and Interest.

THE payment made for the use of capital is called interest. It is always reckoned at so much per cent., say, 5 per cent.—*i.e.*, £5 per annum for the use of every £100. When an entrepreneur borrows capital for the use of his business, he frequently offers to make a certain rate of interest the first charge on the "profits" of the company, using the word "profits" in the business sense. This is the meaning of the "debenture" shares of some companies, the "ordinary" shares of which take what they can get.

The machinery of wealth-production is kept going in order to supply goods to satisfy human needs, and hence it follows that the kind of work it is doing at any given moment depends on the needs which want satisfying, but obviously there is always a vast aggregate of unsatisfied needs. There are some, but not many, individuals whose incomes are so large that they can satisfy every need, and indeed gratify every whim, but although these people loom large in the public eye, there are too few of them to make any real difference. And on the other hand, notwithstanding the fact that there are many very poor people, it is also true that the bulk of people have incomes more than large enough to satisfy the most urgent needs, so that they can leave other secondary needs unsatisfied if they choose, and, as we shortly put it, "save the money." When a man thus defers the satisfaction of a need he is entitled to some reward for doing so, because it is just this postponement of satisfaction in the present that enables society as a whole to get wealthier than it otherwise would be, and of this increased wealth he should get his share. If a man's income has been paid him in gold, say £500, he has this amount to spend in the satisfaction of his wants until pay-day comes round again. It is really astonishing how quickly £500 can be got rid of by a man who puts his back into the job; but let us suppose that this particular man by cutting down his expenses can manage on £300 during the interval. Now, if he buried the £200 in his garden, the only thing that would happen would be that when he dug it up again (providing that gold was still in use as money) he could use it in purchasing more goods. Modern arrangements give him a far better alternative, for he can always "invest" it. Instead of burying it, which is mere foolishness, or using it up there and then in satisfying needs by purchasing goods out of

the existing stock, his "investment," if wisely planned, puts it into the hands of men who will use it in productive enterprises which could never be undertaken if he (and of course he is only a type of millions) had not acted as he has done, and which result in making the future stock of goods bigger than ever. The process cannot be overdone, for the simple reason that if everybody cut down his present consumption to the bone, so to speak, in order to save, the prices of the existing stock of goods would fall so low that entrepreneurs would not come forward to borrow the "savings" for productive purposes.

Investments vary greatly in character, and a new enterprise is often merely a gamble. If a man wants to keep his capital safe and certain, so that he can realise it at a moment's notice, he must choose some form of investment which gives him this power, and in such cases he gets what we may call "pure" interest. Government and municipal loans, mortgages on good property, old and firmly established businesses of all sorts ("gilt-edged" securities, as they are called) provide this. If he invests in a new concern there is always an element of risk, and if he runs the risk and is successful he gets a higher rate of interest.

At bottom, however, what determines the rate of interest is the number and character of the ways in which new capital can be remuneratively applied. People will not invest in old sources giving a low rate, when new sources are becoming available which give a high rate. Hence the prices of the old shares fall—the simple explanation of the fall in Consols.

All through these papers, the object is to find out how the social machine is constructed and what forces set it to work. This is a purely scientific undertaking, but there is no reason why we should not pause every now and again to reflect upon the special interests of the working classes.

Now every man who finds out a new and more profitable method of investing new capital, thereby does two things to help the working classes. He does not do it in order to help them, but to help himself; and, on the other hand, the workers are inclined to be a little suspicious when they are told that a capitalist, solely concerned in looking after his own interests, cannot do it without looking after theirs. In fact, however, this is what happens:—

(1) By providing extra and more profitable methods of employing labour he adds to the demand for labour, without adding to its supply, and this tends to increase money.

(2) By increasing the supply of goods available to satisfy the needs of society, he raises the real income of society, that is, the available supply of goods, and of this increased supply of goods the workers get their share by the usual operation of economic laws.

CHAPTER XV.

The Profits of the "Boss."

IF the reader will refer back to Chapter IX., he will see that all along we have been using the French word *Entrepreneur* to signify a man who runs a business on borrowed capital, and that practically no difference arises from the fact that many employers own the whole or part of the capital sunk in their business. All that we have to do is to remember that the business man uses the word "profits" in a wider sense than we are now using it. To him the "profits" are that sum of money which remains over for his own private behoof at the end of a financial year after he has met all the expenses of running the firm, including, if he is

wise, contributions to two important items—the reserve fund and the depreciation account. The object of a reserve fund is to equalise “profits” (in his sense) over a period of years, some of which are bound to be bad, while a depreciation fund is used to keep capital, which always suffers from wear and tear, up to its original standard.

He does not bother about political economy, but still, if you can get him to talk the matter over, he will acknowledge that his “profits” are really a composite product. It contains his “Wages of Superintendence,” as Mill called it—the reward, that is, of his own work as head of the firm. It contains what in the last paper we called “pure” interest on the invested capital, part of the investment being in many cases in the land the factory stands on, so that here, “profits” contain “rent”; and finally, an indefinite but very real addition to this pure interest, due to the risk of losing the original capital. Now, when all these items are accounted for, it is clear that on economic grounds there ought to be nothing left over. Every economic factor which contributed to the result has been duly rewarded—the landlord, the workers (including the boss in his capacity of worker), and the owners of the capital, have had all that economic law entitles them to. If there is still something over, we are going to call that something “profits.” Let us see where this something, “profits,” comes from.

We assume, as the starting point of our search, that there is only one price for one commodity in one and the same market. We see the best, of course, in retail shops, where a certain size tin of a certain definite commodity (say “Cowboy Brand” of condensed milk) sells for the same price throughout a town, but it is substantially true, and tends to be absolutely true, of all commodities.

Now looking at the commodities from the buying point of view, we know that one of the most important factors in fixing their price is the urgency with which they are wanted by buyers. If A is the only maker of a certain article, he does not bother himself about what it costs him to produce it, but only what he can persuade his customers to pay for it. If there are a lot of men, A, B, C, D, . . . X, making it, none of them can do as he likes. Competition keeps down the price to the cost of production; but—and here comes the vital question—whose cost of production, A's, B's, . . . or X's? A is, we will say, a man whose business has old and firm connections, whose factory is up-to-date, conveniently situated, with a railway on one side and a tidal water on the other, and a huge town near by for a steady market—a description suggested by a recent visit to one of the most successful firms in London. X, on the other hand, is miserably deficient in all respects, and B, C, D, etc., vary, none being so good as A, and none so bad as X. Again, we ask, whose cost of production fixes selling price?

The answer is the cost of the poorest man whose commodities are needed. When the article is in strong demand X can get his price, and so all those more fortunately situated can also get X's price. As the demand slackens, X falls out, and say, D gets his price, all below him actually losing—for losses can be made in business as well as gains. We see, then, that the source of "profits," as we have defined them, is the possession of special advantages for production. They are closely similar, therefore, to rent, and might be called the "rent of special advantages for carrying on business."

Competition, however, tends to cut them down. A French economist has said that the law of profits is that they tend to become zero, and a business friend of the writer's was so

struck with the accuracy of the expression that he conceived a very great respect for economists, whom he had clearly regarded hitherto as rather futile persons.

If the production of a particular commodity is giving unusually good net returns to the firms in the business, it usually happens that new firms break in on them and at once obtain a share of the market by cutting prices. This competition may come from home firms, for there is always plenty of capital available for any new business that promises high profits, or from foreigners. Of course, this is very unpleasant for the original firms, and they naturally try to prevent it, and the ways in which they do this need to be closely studied.

CHAPTER XVI.

Competition and Combination.

SOME of the advantages possessed by the better situated firms (A, B, C, and D, of Article XIV.) in a given industry accrue from the simple fact that there they are, already in possession of the field. A new firm has always to struggle hard to get on its feet, and its available capital may be exhausted before it has got properly started. Its competing power can only be expressed in its prices, and consequently its prices may be lower than its expenses of production justify. It is, in short, living on its capital, a process which ends, sooner or later, in bankruptcy.

In the absence of the special conditions to which we shall refer later, existing firms can only keep out new competitors by keeping their

prices down to a level below which no new firm can go, and this can only be done permanently by keeping down the expenses of production. One way of doing this is to produce on a larger scale. Experience shows that a firm which is producing, say, 100,000 units of a given commodity in a given period can turn it out at a lower cost per unit to the firm than another firm turning out, say, 50,000 units. The economy of large-scale production springs from many sources; some elements in cost (*e.g.*, clerical work, light and power) increase slowly while the output rises rapidly; there are obvious advantages in buying raw materials on a large scale; an extensive connection has more points at which to grow, and if orders shrink at some points they are likely to be expanded at others. Division of labour can be carried further; men can be put in charge of single departments and become experts in it, for a man may be almost a miracle at buying raw materials and a perfect fool at selling the finished articles; machinery "pays for itself" more quickly and can be "scrapped" earlier, making room for later and more perfect models.

All this is obvious enough; what is not so obvious is that it is not a process which can go on indefinitely. There is no economic ground for supposing that a protective tariff will enable us to produce on a larger scale, though the examples of America and Germany are held up as proofs. There is something very muddle-headed in this, for, as we shall see in a moment, the supposed larger scale production of these countries is something quite different. Large scale production comes, and can only come, from the growth of a particular firm; and if there is one thing which we may take as axiomatic, it is that English business men have now, and long have had, the brains, capital and experience necessary to enable them to produce on the largest scale which pays.

So far we have only been considering that kind of growth which has as its object the turning out of product at a lower cost per unit, and so enabling it to be sold at a price which makes the competition of new firms not worth troubling about, since if new firms start they must find new markets. The growth of a single firm is one thing, the combination of a number of firms another, and very different thing. Everybody in Lancashire and Yorkshire knows of firms which began, perhaps half a century or more ago, in a cottage; and are now housed in monster buildings that cover acres. That is growth of the first kind, wholesome and beneficial. But when a group of similar firms unite into a Ring, Combine, Syndicate, Kartell, or Trust, the main object of the union is not to get the advantages of large scale production, but to secure unanimity in dealing with the consumer. There are other advantages, but these are incidental to the main one. It is clear that the actual scale of production may remain quite unaltered.

In the lower form of combination, of which the German Kartell is typical, the separate firms retain a large measure of independence, the Kartell determining only the price and selling policy. All receipts for sales go to the central administration, and profits are divided among the firms according to a scale agreed on at the time the Kartell was formed. The American "Trust," as it is popularly called, has developed through the looser forms of combination until it has become a unified firm.

The object throughout is to obtain and retain the power to determine the price at which the consumer shall buy. The plan is to make it impossible for outsiders to start operations, but if these outsiders are outside the national boundary, a new difficulty arises. In practice the solution has proved easy, for the foreigner has his power to compete curtailed, and even

annihilated, by protective tariffs. In this country we hear little of combinations of producers because our fiscal system so narrowly limits their power to affect the public that their existence and operations are practically unnoticed.

CHAPTER XVII.

The Mechanism of Exchange.

(1) Money.

MONEY is the first thing which every one of us has to think about in practical life, and the reader of these papers may be inclined to ask how it comes about that what is so important to the individual is something which the economist does not write about until he has got quite a long way with his description of the wealth-producing machinery of modern life. One of the very best books on "Money," that written by Professor Jevons, opens as follows:—

"Some years since, Mademoiselle Zelie, a singer of the Theatre Lyrique at Paris, made a professional tour round the world, and gave a concert in the Society Islands. In exchange for an air from Norma and a few other songs, she was to receive a third part of the receipts. When counted, her share was found to consist of three pigs, twenty-three turkeys, forty-four chickens, five thousand cocoanuts, besides considerable quantities of bananas, lemons and oranges. At the Halle in Paris, as the prima donna remarks in her lively letter, printed by M. Wolowski, this amount of live stock and vegetables might have brought four thousand francs, which would have been good remuneration for five songs. In the Society Islands,

however, pieces of money were very scarce; and as Mademoiselle could not consume any considerable portion of the receipts herself, it became necessary in the meantime to feed the pigs and poultry with the fruit."

Mademoiselle Zélie had goods and no one to sell them to for money.

You will remember that when Robinson Crusoe was searching the wreck for goods that would be useful to him, it is recorded that he "found about thirty-six pounds value in money, some European coin, some pieces of eight, some gold, some silver." Was he pleased with his find? Not at all, for these were his words: "I smiled to myself at the sight of this money. Oh drug! said I aloud, what art thou good for? Thou art not worth to me, no not the taking off the ground; one of these knives is worth all this heap; I have no manner of use for thee; e'en remain where thou art, and go to the bottom as a creature whose life is not worth saving." Robinson Crusoe, however, was a creature of civilisation even though he was alone on a desert island, so on second thoughts he took it away. Crusoe, you see, had money and no one from whom he could buy with it the goods that he wanted.

One other simple illustration and we shall get to the root of the matter. One fine day in the middle of last October, little Tommy took advantage of a school holiday to go black-berrying. He collected a fine basketful of them. At first he ate some of them himself, but he soon got tired of eating blackberries. Why then did he go on gathering them? For a very simple reason. When he had filled his basket, he took them back into the village and sold them to the Vicar's wife for a shilling. As soon as the shilling was in his hand, Tommy raced off to the little general shop in the village, satisfied himself by a rapid glance that the cricket ball, price one shilling, which he had been looking greedily at for weeks,

was still there, darted into the shop, put down the shilling, proudly took possession of the ball, and went off to play with it.

Now a shilling is money. What had this particular shilling done? It had shifted a basket of blackberries out of Tommy's hand into the hand of the Vicar's wife, and it had shifted a cricket ball out of the shop-keeper's hand into Tommy's.

This is the essential thing that money does for us. It is precisely like a waggon in its economic function. It shifts goods about. And just as it would be foolish conduct for us to go on building waggons unless there was goods for them to shift about, so it is useless for us to go on making money, whether golden sovereigns or paper Bradburys, unless we make goods for the new money to shift about. If we make more money and no more goods, prices rise. Once more, it is obvious that we have come by another path to the old point, namely, that the great need of the day is increased production. Make no more money, but make far more goods, and the same money having more goods to shift, will shift more of them at a time, that is to say, when you take your Bradbury into a shop you will bring out a bigger basketful of goods.

One other important point about money. Anything can be used as money provided that people take it from one another on sight and without question asked. Some years ago I showed a class of children how a pound weight made of iron would float in a big glass bowl of mercury, just as a cork floats on a glass of water. Then I put a sovereign into the mercury, and though it weighed only a trifle in comparison with the floating iron weight, it sank to the bottom. This greatly delighted the children, but the result of the experiment did not greatly delight me, for the mercury silvered the sovereign and made it look almost exactly like a shilling. It was a

real sovereign right enough, but for days I tried in vain to get a tradesman to take it. Finally, a friendly bank manager, after smiling at my account of what had happened, put the silvery sovereign in one pan of his scale and an unmistakable sovereign out of his till into the other pan. Now the real test of a sovereign is not its colour, nor its shape, nor its markings, nor its size, but its weight. There is nothing else in the world which weighs precisely as much as a sovereign. My silvery sovereign and the unmistakable sovereign were of precisely the same weight, so I got the latter and the former went into the till to have the mercury rubbed off it in the course of a week or two by jingling up against the others.

Whatever does the work of money, that is, whatever shifts goods about at once and without question, *is* money.

CHAPTER XVIII.

The Mechanism of Exchange.

(2) Banknotes.

MONEY, then, is the tool by means of which exchanges of goods between man and man are conducted. An obvious consequence of doing this work is that money also measures the relative value of goods in the market in which the exchanges take place. If in Liverpool a bale of cotton sells for £10 and a quarter of wheat for 50s., we deduce that a bale of cotton is worth four times as much as a quarter of wheat. It is most interesting as well as most important to watch changes in value. A needle is not worth much now, but one of the first English dramas turns on the loss of Gammer Gurton's Needle, a loss so im-

portant that the whole village is comically upset by it, until it is discovered in her man Hodge's trousers, which he had put on before the task of mending them had been completed.

All we ask of money, then, is that it will do what carts do—shift goods about. Now in one respect, unfortunately, coins are like carts—they cost much in human labour to make. As our standard coin we use the sovereign, a piece of gold, 11/12ths fine, weighing when new 123.27447 grains, shaped and stamped in a particular way. It is not easy to mistake a false for a real sovereign if the most ordinary care is used. The ring is difficult to mistake and the weight impossible. In my own case the sovereign was decided to be real the moment it was placed in the balance. Sovereigns are legal tender to any extent. If Lord Rothschild owed Mr. Lloyd George ten million pounds, he could settle the debt by sending along ten million sovereigns. It would take Lord Rothschild all his time to get the coins together, and Mr. Lloyd George would be terribly disconcerted by being paid in such an unbusinesslike fashion, but legal payment it would be. It used not to be so with our silver coins, which, before the war, were only legal tender up to £2, for then they were really "tokens," worth twice as much as the silver in them, and therefore very well worth forging out of the real metal. Now, owing to the rise in the price of bar-silver, a shilling, like a sovereign, is worth the metal it contains.

Now all the sovereigns in England had to be got here from abroad, and of course the foreigners who mined them wanted paying for them, in cotton goods, boots, machinery, and so forth. Truly, then, it is a great pity that we cannot make our sovereigns out of something that costs us little or no labour to produce. If pieces of paper, for example, would do just as well, we could ship all our sovereigns

abroad and get useful commodities for them, and use the paper for money.

As a matter of fact we see that pieces of paper are constantly used to make payments. The same necessity that produced metallic money in times so far back that we have no record of the invention, has in modern times produced paper money. The amount of goods to be shifted about has utterly outgrown the shifting capacity of our stock of coins. If all the merchants and manufacturers in Liverpool and Manchester suddenly took it into their heads to insist on being paid in hard cash, the trade of Lancashire would come to a standstill. It simply could not be done. There are neither the coins to do it nor the time to do it in.

The use of pieces of paper to represent money is, then, the only way in which modern business can be conducted. There are numerous kinds of paper money, from the postal order, worth 6d., to the Treasury Bill, worth £5,000. The war has made us only too familiar with the "Bradbury" or "Currency Note."

Let us begin with the Bank Notes. The "fiver" of ordinary talk being the best known, though there are higher denominations. Now, the peculiarity of the Bank of England note is that it is just as truly legal tender for a debt as gold itself. A man owes me £5 and tenders 100 shillings. I can refuse. He tenders me a cheque. I can refuse. He offers me five sovereigns or a "fiver" and the offer of either settles the matter. If I refuse now the loss is mine. The reason why a Bank of England note is legal tender is simple enough, and if the reader will, when he gets the chance, call in the Bank in Threadneedle Street and present a "fiver," he will see why. In an ordinary bank or shop the man hands out the gold and carefully puts the note away. In the Bank the clerk pays out the gold and then

tears the note. There is no room here to explain the Bank Charter Act of 1844; it must be enough to say that, with exceptions which do not really matter and would take long to explain, a "fiver" represents an actual five sovereigns stored away in the Bank, so that when the Bank parts with the coins it necessarily has to destroy the paper that represented them. The English bank-note is "convertible on sight."

For a short period during the Napoleonic wars this was not so. The Bank was by law relieved of the obligation of paying gold for its notes when they were presented to it. The "assignats" of the French Revolution and the "greenbacks" of America are famous instances of "inconvertible" paper money. In these days of living pictures it may be useful to point out that in American pictures we notice that all payments are paid in paper—"wads of money," as the Americans call them.

In all the leading countries the issue of bank-notes is strictly controlled by the government, so that the perfect convertibility of them may be secured. In this respect the system inaugurated in England in 1844 has been followed more or less closely. It is an integral part of this system that the government itself should not have power to issue notes. For notes are legal tender, and if the government could issue them at will it would be under a constant temptation to get out of its financial difficulties by the same simple process of setting a printing machine to work to "make money" wherewith to buy Dreadnoughts and pay salaries.

CHAPTER XIX.

The Mechanism of Exchange.**(3) Cheques and Banks.**

THE commonest way of making payment by means of paper is to "draw a cheque." All business men, and private people of means—even of moderate means now-a-days—pay all the money they receive into their bank, and when they have payments to make they send cheques on this bank to their creditors. A cheque is simply an order from A to his banker B to pay C the sum on the cheque. When the law forbade the issue of notes by private banks, the cheque was invented to serve the same purpose. Of course, B, the banker, will not pay C unless A has a deposit to his name sufficient to cover the amount, though this deposit, as we see, may be an imaginary amount lent him by the bank. Cheques for very large sums are not uncommon, for the writer has just seen one for over £250,000.

Suppose that A and C both keep their accounts at B's bank. In this case B has only to alter figures to settle the debt. He makes A's account less and C's account greater by the amount of the cheque, and payment is made without the use of a single coin. If A's bank is not the same as B's, but is in the same town, the system is easily expanded. In this case C sends the cheque to his banker D, who has to get the money from B, but it is sure to happen that another man E has drawn a cheque on D in favour of F who banks with B. The bankers simply change cheques, make the necessary alterations in their books, and two debts are settled. This is the system adopted now in all large towns. All cheques received

by one bank and payable at another are sent to a central "Clearing House," where each bank gets its credits balanced against its debits, receiving or paying the difference only, and that, too, by means of other cheques drawn on or in favour of the Clearing House, so that in the end the daily payments of the country, amounting to scores of millions of pounds, are settled with the aid of a very small amount of coin. The cheques cleared at the London Bankers' Clearing in 1910 amounted to £14,659,000,000.

If a banker had to keep in his possession the exact amount of money he had on deposit, he could make no profit on his business. But, as everyone knows, a banker can in ordinary times get along quite well with only a fraction of his total liabilities available in cash. The amounts paid in day by day, on the average of a reasonable period, are greater than those paid out. Hence he has always capital available which he can lend on interest, and this provides his chief source of profit.

The fly-wheel which steadies the machinery of this huge and complicated system of credit operations is gold. I take a man's cheque in payment of a debt because I assume that he has a credit at the bank; I pay the cheque into my own account because I assume that the bank will always meet my cheques up to the amount of my deposit. The assumption is true in the vast majority of cases. Occasionally, however, this assumption either ceases to be true, or people think that it is—and jest or earnest makes little difference to the ultimate result. The machinery of credit is apt to come tumbling down about our ears, and a financial crisis is the result. There was such a crisis in America in the autumn of 1908. Our own banking system has for long proved itself immune from serious collapse, though critics think it capable of improvement. All banks have got into the habit of banking at

The Bank, and some say that their own reserves may therefore be possibly insufficient to ward off a threatened crisis.

Although our account of the ways in which payments are made by means of paper documents is not yet complete (for one of the most important of these documents has yet to be described), we may now lay down the great law of money. As the quantity of money in circulation varies, prices vary, providing that the amount of goods to be sold remains constant. An increase in the quantity of money leads to increased prices, and vice versa. If the amount of money is increasing and the stock of goods is increasing too, the change in prices will, of course, not correspond merely to the increase in money, but to the relation between the two.

The effect on prices of an increase in the amount of money in circulation, which is obvious in theory, has been very marked in practice during the last twenty years. In the fifteen years preceding the war vast amounts of new gold were poured out from South Africa, at a rate which promised, if maintained, to double the world's stock of the yellow metal by about the year 1932. This output of gold led to a marked rise in prices. If all incomes had gone up exactly as much as prices, no one except the gold producers would have been a single penny the worse or better, but unfortunately, when prices are rising all round, there is one "commodity," labour, the price of which always tends to lag behind in the movement. Between 1900 and 1910 wages in this country remained at about the same level, while prices rose ten per cent.

During the war the history of money and prices has attracted the interest and attention of every one of us. To begin with, a new form of paper money, the currency note or, as it is colloquially called, the "Bradbury" was introduced and issued on a very large scale. The sovereign disappeared from use, and as

for every sovereign in use before the war it is probable that two Bradburys are in use to-day, the effect of the increase in the currency on the level of prices hardly wants arguing.

CHAPTER XX.

The Mechanism of Exchange:

(4) Foreign Bills.

SO far as money values are concerned, the year 1919 was a record year of British trade. Every working day of the year we imported goods worth £5,200,000. Large armies of foreigners and of our fellow subjects overseas contributed each day to this vast total. Of each of them it is true, naturally, that he wants paying for his goods. How does he get paid?

It does not matter what the foreigner has sent us, or where he lives, he always does one and the same thing, in the absence of special reasons to the contrary. In order that we may follow his conduct and its consequences, we will discuss an actual case.

On November 20th, 1906, a certain manufacturer of Zurich, in Switzerland, sold to a friend of the writer's, living in London, ladies' dress goods worth £453 9s. 9d. Having sent off the goods he wrote the following document. The actual document, in French, is before me as I write, and I simply translate it, except that I call the Zurich manufacturer E.S. and the London importer W.D. :—

Zurich, Nov. 20th, 1906. £453 9s. 9d.

Three months after date pay by this first of exchange to our order the sum of four hundred and fifty three pounds, nine shillings and ninepence sterling, and place the same to our account as advised.

To W.D., London.

E.S.

Here, then, is the position: W.D. with the goods in London and E.S. with the document in Zurich. What happened to the document? He sold it to a firm, Messrs. F, who paid it into a bank, and then the bank sold it to a firm, Messrs. M, who in turn posted it to Berlin, where it finally turned into the Imperial Bank, the manager of which posted it to the manager of his branch at Crimmitschau, who sold it to a certain Herr B. How do I know this? Simply by the endorsements on the back which tell their own tale quite plainly. What did Herr B want with it? He wanted it to pay to a London firm G and P, from whom he had purchased goods, and when the three months were up, G and P sent it to W.D., who wrote his name across the face to acknowledge his debt, whereupon G and P paid it into their bank, which paid it into W.G.'s bank, which gave G and P's bank credit for it, after deducting it from W.D.'s account. So that the goods which W.D. bought from E.S. in Zurich were paid for by the goods which G and P sent to Crimmitschau. Such is the life story of a typical "bill of exchange" or "bill on London." Some are more detailed, and go an even more circuitous route from birth to death, but the principle and effect is always the same. As a rule these bills accumulate in hundreds in the hands of London foreign bill brokers, who buy them up at less than their face value, and get the whole of this at maturity. I have seen enough of them at once in a small room in "the City" to buy up one of the smaller German states, for there are supposed to be something like £150,000,000 worth of them about on the average.

When a foreign exporter to England has written his bill he goes out to sell it, for the bill stands for sovereigns in London in three months time, and he wants, say, francs in Zurich here and now. Clearly, if in any foreign country the number of exporters to

England increases, the number of bills on London increases too, and unless the importers from England (the buyers of the bills) have increased equally, some bill sellers will be left with their bills on their hands, and will have to part with them at a sacrifice. This slackens their desire to sell to England, and makes the buyers of the bills (the importers from England) all the more anxious to buy from England, and this soon puts matters right by decreasing our imports and increasing our exports.

Now, if we ever have too much money prices rise accordingly, and our exporters do not get so many orders. Hence abroad the number of bill buyers goes down, and some bill sellers have to wait out the time and get the gold from London. This automatically drains us of unnecessary gold. Of course, exactly the reverse happens when we find ourselves short of money.

During the latter part of the war and the whole of 1919, the American Exchange was so heavily against us that the English pound sterling came at length to have a purchasing power in New York of rather less than 17s. No wonder that prices went up! There is only one cure for this state of things. We must export more or import less. Which are we to do? We cannot do without our imports, for they consist in the main of food and raw materials. The best economic remedy, therefore, is to export more, and this can only be done by producing more in order to have more to export. It used to be said that all roads lead to Rome. In these days, whenever the economist settles down to put his thoughts on paper, it is curious how every train of thought leads him to one and the same conclusion—the necessity for increased output.

CHAPTER XXI.

The Commercial Commonwealth.

IT is a tempting task to try to thread the infinitely numerous and various facts of a long and complicated history on a single thread of logical development. Usually, however, it is useless to attempt it, and economic history is no exception to the rule, for all sorts of threads lie at hand for choice, and it is impossible to say which is the most useful. We cannot help but observe, however, that the development of means of exchange is one such thread, and, further, that the gradual perfection of the tool money has led to an extension of markets. We have had in succession barter, coins, notes, bills, and cheques, and also in succession no market, a small local market, a national market, and now, for many important commodities, an international market. The dealers in the Liverpool markets for corn and cotton are influenced by the doings of the dealers in Chicago and New Orleans, and vice versa, and both sets in each commodity watch each other carefully.

The chief agents in linking the world together have been the steamship and the telegraph. The movements of goods have been regularised to a nicety. The captain of a grain steamer from the Argentine comes into the mouth of the English Channel, and there receives, perhaps even by wireless, a message from his owner's agent, telling him where to proceed with his cargo, for the telegraph has kept the agent in touch with every corn market in Europe, and enabled him to sell to the best advantage. Merchant houses in Calcutta and Hong Kong, Valparaiso and Sydney, San Francisco and London, New York and Hamburg, are now for all practical purposes as

near neighbours as if they were side by side in Princess Street, Manchester, or Wood Street, London. The world is steadily becoming a commercial commonwealth that knows nothing of Jew or Gentile, Greek or Barbarian. National boundaries are still formidable barriers, but commerce is steadily breaking them down for, at any rate, its own purposes, and other purposes are so linked with them that the forces of union are steadily making headway against the forces of disunion. If two great countries were to go to war, the mere state of war would inflict the gravest injury on thousands of the leading citizens of each. Take a simple point: When England and Germany went to war, all contracts existing between their subjects were suspended or extinguished—a very awkward matter for all concerned.

The nations composing this commercial commonwealth differ widely among themselves in economic character. They may be broadly classified into old countries and young countries. England is the typical old country in this economic sense. In the main it imports food and raw materials and exports manufactures. The Argentine is the typical young country, exporting food and raw materials and importing manufactures. The great trade routes run between these two groups.

The development of the commercial commonwealth is perhaps best seen in the fact that capital has practically ceased to be restricted by national boundaries. The wealthier old countries, France, Germany, and, above all, England, have lent enormous sums to aid in the development of the younger countries. As we now know, this capital consists almost exclusively of goods, and when we say that England has invested £3,500,000,000 abroad (half in our colonies and half in other young countries) we mean that we have manufactured

the component parts of capital to that extent and shipped them abroad for use in the countries to which we have lent it.

And just as capital goes abroad as goods, so the interest on it comes back as goods. Our capital was tools and machines, our interest is food and raw materials. If Germany were to borrow from us she could only pay interest in manufactures, and consequently our loans to Germany are so small as not to be worth considering. There is a maximum of advantage to us in the arrangement. Even if none of our capital went to our brethren overseas the advantage would still persist, but we are deriving a further political advantage when we send our capital to develop our Empire. Complaints of capital investments abroad are the shibboleth of the ignoramus in economics.

While no one, least of all a Briton, would desire to diminish the spirit of national pride, the world's future manifestly depends on strengthening every link that binds the civilised nations into a commercial commonwealth, and in weakening every artificial barrier between them. Language and race are national barriers, and we can do nothing to alter them. Some things—*e.g.*, different currencies, weights, and measures—are just as plainly artificial, and uniformity would be an immense advantage. But the chief artificial barrier is the tariff wall, and we render an immense service to the world by the mere fact that our foremost place in the commercial world has been won by and can only be maintained by Free Trade. We carry half the world's goods across the sea, and we do at least one-sixth of the total overseas trade of the world on our own account.

CHAPTER XXII.

The Principles of Taxation.

GOODS, Incomes, and Markets, the first three of the leading topics of economics, have now been dealt with. Taxes remain for consideration. As a subject of study they yield to none in interest. It is only when we come to pay them that they become a nuisance. But this is incorrect, though unavoidable, human nature being what it is, and the economist is doing one of his best services when he explains what taxes are, what they should be, what they do, and what they should do. For the study of taxes is one of the most practical topics to which we can devote ourselves.

Taxes are always studied in economic treatises in a separate "book" (*e.g.*, Book V. in both Adam Smith and John Stuart Mill). There is, now-a-days, a tendency, which has its disadvantages, to treat taxation in separate volumes. Taxes belong closely to our previous subject. They form an income, the income of the government, and we have endeavoured to link income with effort, showing that each class of income is derived from a contribution to the total work of production. We must not lose sight of this, but we must find out what it is that Government does for us that earns an income.

Again, the taxpayer should be drilled into the belief that when he pays a tax he is just as truly buying something as when he goes into a shop and pays half-a-crown for a cap. He willingly pays for the cap, because he sees the result in a useful commodity. He pays his rates and taxes unwillingly because he does

not see the result. If an Englishman emigrated to the middle of Africa he would see the result at once, for he would miss dozens of agreeable things there which he had here because he paid taxes. What we buy with our rates and taxes is the comfort, order, and decency of life in a civilised State, and when we are all as uniformly keen on getting good value for money when we pay a tax as when we pay for a cap, our country will be far better worth living in than ever it has been.

"Taxation is distinguished from confiscation only in degree," says Lord Hugh Cecil in his recent and very useful little book on "Conservatism." It is an unusually plain statement of an old view which is, I am obliged to say, as muddle-headed as it is mischievous. For an acute man, looking at the matter purely from a business point of view, might well say: "The Government is cheerfully welcome to every farthing of my income, on the understanding that it gives me and mine a better supply of the things we need than I manage to get out of it for myself. As things and Governments are now, I am so certain that I should lose on the whole by the change that I should strenuously object to making it, but along any particular line where government can do better for me than I can ever do for myself, an increase of taxation is something for which I am even now quite ready." Paying taxes and getting value for them is the first duty of citizenship, and to it the idea of confiscation is abhorrent.

The duty of deciding what the taxes of this country shall be rests with the Chancellor of the Exchequer, subject to confirmation by the House of Commons. In practice, of course, he each year proposes a number of taxes—*income tax—death duties, excise duties, customs duties, and so on.* We may, however, in our own minds, lump them all together

in a single tax, and ask ourselves: "What advice would we offer the Chancellor of the Exchequer when he is determining what tax each of us shall pay?" In other words: "What is the ideal to be aimed at in taxation?" In the text books of Economics this question appears thus: "What are the Canons of Taxation?" The most famous list of these canons is in Adam Smith's "Wealth of Nations." Taxes, he said, in effect,

- (1) Should be certain in amount;
- (2) Should be payable at the most convenient time;
- (3) Should take from the pocket of the taxpayer as little as possible over the net amount received by the Government; and
- (4) Should be equal as between citizen and citizen, the test of equality being that they should be proportional to income.

The first three canons were commonly neglected when Adam Smith wrote, but are pretty clearly observed now, at any rate in England. It is the last canon that still troubles us. How are we to decide that taxation is fair as between citizen and citizen?

Fair taxation will take fair account of two great facts. First that incomes vary, and that the power to pay taxes increases much more rapidly than income increases. When a man's income has risen from £1,000 to £2,000 a year he can pay more than twice as much in taxation even on the sacrifice theory, since his doubled income more than doubles for him the amenities of civilised life. In practice this consideration should lead (a) to the setting free from compulsory taxation of all incomes below a certain standard; a man earning less than a given sum if he pays at all should pay voluntarily by buying a taxed commodity he is not really compelled to buy—*e.g.*, whisky; (b) to

an increased rate in the pound on the higher grades of income—proportional taxation, as it is called.

The second great fact is that some incomes are earned and precarious, and others unearned and permanent. A man earning £800 a year as a doctor is not so well able to pay taxes as a man getting £800 a year as the rent of his freehold land. The doctor's income will cease when he ceases to work; the landlord's income will not cease even at death, but will be continued immediately to his successor. This makes a fair case for taxing the second class of incomes more highly than the first.

Both these great facts are reasonably allowed for in our existing tax system.

CHAPTER XXIII.

Taxes on Goods.

ALTHOUGH it is quite obvious that the payment of a tax always falls on a person or is divided amongst a group of persons, it is often quite impossible to ascertain who it is that pays it, or how the payment is divided amongst the group on whom it falls. This is especially true of a tax that has been so long in existence, such as our present land tax, so that it has been paradoxically said that "an old tax is no tax." Everybody must have noticed how soon the disturbances and disagreement caused by new taxes pass away. People get used to them and forget them. Certainly an old tax is the best tax, and hence a wise Chancellor of the Exchequer makes as few changes as possible, and makes big permanent changes when changes must be

made. Mr. Gladstone in 1853, Sir William Harcourt in 1894, and Mr. Lloyd George in 1909, rightly acted on this principle.

While taxes must necessarily be paid by some person or persons, known or unknown, it is common and convenient to speak of taxes on "goods." Sometimes the best way of collecting a tax is to go direct to the individual who is to pay and get the tax from him in money. There are the so-called direct taxes, the best-known example of which is the income tax. Sometimes the only way of getting at an individual is a roundabout one. To compel men to take out a license to smoke would be absurd, as everybody would evade it by smoking only when indoors. By adopting the simple plan of taxing the tobacco when it arrives in this country all smokers are effectually taxed, for the importer who pays it to the customs officials adds the tax to the price of the tobacco, and so step by step it gets to the man who buys the tobacco to smoke. Few smokers realise that when they buy a shilling's worth of tobacco they have paid a tax of about tenpence. Such taxes are called indirect, and in this country the chief goods so taxed are alcoholic drinks, tobacco, tea and sugar.

It is a leading principle of sound taxation that a tax should be a tax and nothing else. Its chief object is to get revenue for the Government, not for some private individual, or perform any other function. Let us recall the important economic law laid down in our study of markets, that for similar commodities in the same market there is only one price. In the restaurant car of a train on which the writer frequently travels he hears the diners ask for a lager. Now, lager is a German drink, which is imported in large quantities, but it is also manufactured at home. If quality and quantity be equal, a bottle of imported German lager will sell for the same price as a bottle of home-brewed lager. Now,

we all know that English breweries are visited by Government officials, called "excisemen," who gauge the quantity brewed and levy a tax on it called an excise duty. Suppose this tax to work out at 3d. on a bottle of English lager, which sells at 6d. in the "diner." Therefore, in the "diner" a bottle of German lager also costs 6d. But if there were no tax on the German lager it would be grossly unfair to the English brewer, who would be completely swamped if the German offered his lager for 5d. So to put matters right, the same tax must be levied on imported German lager as is levied on home-brewed lager. But, what is sauce for the goose is sauce for the gander. It would be grossly unfair to the English drinkers of lager if no duty was levied on the English brewer, while the German paid our supposed tax of 3d., for by selling English lager at 5d. the German lager could be kept out, while the whole of the 2d. would not go to the English Government, but to the English brewer. In this case, the import duty would be a protective duty levied in the interests of a favoured group of manufacturers.

If it were proposed to select only one article for this special treatment, everybody except the manufacturers of it would cry out against the proposal. Yet when it is proposed to apply the principle to all the food and manufactures we import, some people are unwise enough to suppose that a great and beneficial system would be inaugurated. Very many reasons are given for this, but not one of them contains any element of sound economics. We are, here, looking at the matter from the taxation point of view, and we have only to note that tariff taxes do not change their character merely by being multiplied in number. The idea that the foreigner pays them would hardly be worth discussing even if we had room to do so.

Taxes on goods are paid by persons who are often ignorant of the fact that when they purchase them they are paying taxes. This, indeed, gives them, as things are now, a political advantage over direct taxes, since the "ignorant impatience of taxation," which statesmen naturally do not wish to provoke, is not aroused by them, or, if aroused, is apt to be speedily forgotten. Some great federal countries—that is, countries formed out of originally independent states—have no taxes on persons or no direct taxes. America (as distinct from the separate states) raised nearly the whole of her revenue before the war from customs and excise. Germany, too, had no direct taxes to fall back on, though they existed on what we should think an adequate scale in the various states. It is not generally realised how strongly the Protectionist system of these countries is reinforced by this simple fact that its abolition means the introduction of the hated direct taxes, paid in cash straight out of the citizens' pockets. But whether much revenue or little be requisite, justice demands that taxes on goods should be combined with taxes on persons, for the former fall with peculiar weight on the poor. The idea that there are millions for the Exchequer in taxes on luxuries is absurd. Any single tax is bound to be unfair as between class and class, and it requires a judicious use of both direct and indirect taxation to make a good financial system.

CHAPTER XXIV.

Taxes on Persons.

BEFORE dealing with the second great class of taxes, it will be well to call attention to the fact that the classification into taxes on goods (indirect taxes) and taxes on persons (direct taxes) is not exhaustive. There are what may be called taxes on acts, such as the stamps which have to be fixed on certain classes of documents. Again, some taxes are payments in return for special privileges, such as permission to keep a dog or a public-house; while others are payments for services rendered direct to the payer, as the fee for sending a telegram or a letter.

When the State calls on its citizens to make a direct money payment, it must, of course, lay down some basis on which the amount payable is to be calculated. Ability to pay is the proper test, but how is the ability to be ascertained? Two obvious tests of ability suggest themselves: (1) The income of the taxpayer during a stated period; (2) the value of his property at a certain date. A tax levied on the former is called an Income Tax, one on the latter a Property Tax. It may be noted in passing that the legal name in this country for the former is "Property and Income Tax," because when first instituted it was supposed to be levied on both. In mediæval England the chief direct tax was a real property tax, a "tenth or fifteenth" of the assessed value of the property of each taxpayer.

The Income Tax was once aptly described by Lord Lansdowne as "the milch cow of British finance." It is not, as Mr. Gladstone

said in 1853, a simple tax, but "a code or system of taxation." In that year it produced £5,600,000. Last year the receipts from it reached the enormous aggregate of £46,670,185.

The tax as now levied distinguishes between (1) small and large incomes, and (2) earned and unearned incomes. Incomes of £130 a year or less are left untaxed, a provision which leaves out what we, either too narrowly or rather snobbishly, call the "working classes." Incomes under £700 have a certain amount left untaxed, a proper concession to the "lower middle classes," to use another charming epithet. The tax is levied at so much in the £. Pitt, who introduced the tax in 1789, started with 2s. in the £; Northcote in 1874, reduced it to 2d., in accordance with the Conservative policy of getting rid of it altogether in times of peace.

Before the war the income tax was one shilling and twopence in the pound, but this flat rate was cut into in several ways. It applied only to unearned incomes of five thousand pounds or less, and all earned incomes of £130 a year pay nothing at all, while between £130 and £700 certain allowances were made in respect of children and insurance policies. In the last year of the war, the income tax, including the super tax on incomes over £3,000, was very heavy indeed, and an income of £3,000 paid as much as £962 10s. in income tax, while if of the £3,000 of total income, £1,000 had been what are called "war profits," the total tax on the £3,000 (income tax *plus* super tax *plus* excess profits tax) would have been no less than £1,259 10s., or 8s. 5d. out of every single pound of income.

It is likely, of course, that some income escapes taxation, because the taxpayers understate their incomes. As far as possible income is taxed at the source—*e.g.*, dividends have the tax deducted before being paid. The

recent plan of compelling employers to state the salaries of employees has done much to diminish evasion.

The second test of ability to contribute is fully utilised in this country, by means of the "Death Duties," which, although very much simplified by Sir William Harcourt in 1894, are still impossible. The object of the Death Duties is first and chiefly to raise needed revenues; but, secondly, they have the effect of making the treatment of earned and unearned incomes fairer. We have supposed the case of a doctor and a landowner each getting an income of £800. Until 1894 these incomes were treated almost exactly alike. Liberal finance has quite properly altered this. As we have seen, the doctor pays 2s. 6d. in the £, the landowner much more. When each dies, his property pays the collection of taxes we speak of as "Death Duties" and of course it is obvious that the estate of the latter will pay much more than the estate of the former. Death Duties vary with the amount of the estate and with the degree of kinship between the deceased and his heir. In the last financial year they yielded £25,517,000.

There are other direct taxes in our financial system: (1) the old Land Tax, (2) the New Land Values Taxes—the great novelty of the famous 1909 Budget—and the Inhabited House Duty, but they only yield all told about 3½ million £.

Up to the Harcourt Budget of 1894 it is obvious that the balance between indirect and direct taxation was not fairly held in this country. In Mr. Gladstone's last Budget (1882-3) Customs and Excise duties together yielded £41,000,000, the Income Tax £12,000,000, and the then existing "Death Duties" (which were very indulgent to land as compared with personal property) an amount not worth bothering about. Before the war the two great branches: (1) Customs

plus Excise and (2) Income Tax *plus* Death Duties, yielded about £70,000,000 each. During the war, the necessary increase of taxation weighed more heavily upon the second branch than upon the first. Customs *plus* Excise for the current financial year are estimated to bring in about 238 million £, while Income Tax *plus* Death Duties will bring in 390 million £.

It is commonly objected to direct taxes that they check the accumulation of capital, and, in particular, it has become the vogue to say that recent extensions of direct taxes have driven capital abroad. But even if this has been done, it has certainly been done in vain, for the income on these investments abroad is, on the whole, just as closely tapped as if it had been made at home, and the capital abroad is duly laid under contribution for Death Duties on the decease of its owner. No doubt people find it irksome to pay these duties, but the national expenditure has to be met, and a fair distribution of the heavy burden is the most that can be expected.

CHAPTER XXV.

Rates.

THE sums raised by Local Authorities are called Rates, to distinguish them from the sum raised by the central Government, some of which are called taxes and others duties. The difference of name does not imply any differences in economic theory. Indeed, the old customs tariff of the 17th Century was called "Book of Rates." On the Continent local taxes are often added to the central taxes

and levied in the same way at the same time from the same persons; or again, a common form of local taxation in France is the octroi, a customs duty levied on goods entering a town. Our own rates are now levied in a uniform way throughout the country, and are always so much in the £ on the rateable value (itself always a percentage of the rental value) of all lands and buildings (with some exceptions—*e.g.*, sacred buildings) and mines in the area covered by the authority making the rates—*e.g.*, the stock-in-trade of a shopkeeper—but this was finally given up in 1840 as impracticable, except with regard to machinery.

Rates provide the main source of the income of Local Authorities, nearly 71 millions out of a total of nearly 169 millions in 1908-9. The remainder was derived from (1) sums collected by the central Government as part of its ordinary taxation, and handed over to local authorities—25 million £; (2) receipts from commercial undertakings (gas, electricity, water, trams, etc.), 48 million £; and (3) new loans raised during the year, 24 million £.

If we add together the total income of the central authority and the local authorities for 1908-9, we get the grand aggregate of £320,000,000, which sum is probably 12½ to 15 per cent. of the aggregate income of the people of the United Kingdom. In other words, out of every £1 we receive as private citizens we handed over half-a-crown to three shillings to carry on the government of the country. It is a large proportion, and should make everyone realise the urgent need of active and intelligent citizenship.

The first question concerning local finance is, "Who pays the rates?" It has already been pointed out that the ultimate incidence of taxation—the discovery, that is, of the persons or groups on whom taxes finally fall—is always a difficult and often an insoluble

problem. Turning to local taxation, we have to start from the simple assumption that when a man is looking out for a house he has in mind a certain sum which he will pay per annum to have a roof over his head. Suppose he settles on £50 as his upper limit. Now, it is clearly of no consequence to him that this £50 is divisible to two parts—(1) rent and (2) rates. If the rates on that house are £10 a year, the landlord can only get £40 as rent. The landlord therefore pays all the rates in the sense that his rent would be so much more if they did not exist. If rates fall during the currency of a lease we see at once that the tenant gains, and we know that on the renewal of the lease the landlord will raise the rent.

This view must be qualified to this extent, that rates which are levied in order to supply ratepayers with certain special services are paid by those who get the services. If the municipality did not remove my "dust" I should have to remove it myself or pay someone to do it. If it did not light the streets I should have the expense of a lantern to light me about, just as if I lived in a tiny village.

As a town grows in size its old problems grow in difficulty, and new ones arise. It gets impossible to do without street lighting, and uneconomic to stick to candles and lamps indoors. The town gets too large to permit all distances to be covered afoot, and means of transport become necessary. Now the very things that the people of a town need most because they are townsmen and not villagers—light, water, and transport—are obviously monopolies. Two gas companies (unless, as in London, the town is clearly divided between them) laying mains, two tramway companies laying tracks, in the same street—well, the idea is absurd. But the monopolist who supplies a necessity is in a very strong position for exacting an undue price. One way of preventing this is for the central authority to

step in and limit the charges which may be made. Another and still better way is for the local authority to control the monopoly. This is the theoretical case for municipal trading, and, providing that municipal management is business-like and effective, there is no room for complaint. The usual objections to this "municipal socialism" are old fogeyism gone mad.

The extraordinary increase of rates during the last century—roughly speaking, they doubled between 1860 and 1890, and have doubled again since—has naturally raised locally the familiar national question of finding new sources of taxation. The system of handing the produce of national taxes over to local authorities has been carried far, and muddles all the accounts. Again, what were local burdens only have been more and more taken over by the central authorities—*e.g.*, gaols altogether, and education largely. Two recent national schemes—Old Age Pensions and National Insurance—will largely relieve the rates. These, however, are hardly new sources of taxation, and what many desire to see done is the separate taxation of urban land—but this is too big a problem for a paragraph.

CHAPTER XXVI.

The Final Issue.

IT is one of the finest fruits of the study of economics that the student is insensibly led to attempt to use his knowledge for the benefit of society. It is far too often supposed that the only men who can render effective social

service to their country are those who stand in the forefront of politics, commanding the applause of parliament and shaping the destinies of the nation. It is not so. Social progress does not depend on the leaders so much as upon the led. We have tried to show that economics cannot be learned merely from books. The student must know the workshop and the factory, the market-place and the mill, the exchange and the "city." And as soon as he realises this and gets into touch with the human material out of which society is moulded, and from which it derives its character, he finds that to a large extent the evils of our present system are due to the material and not to the mould. He finds, too, that in all ranks and conditions there are men and women who are centres from which radiate the forces that are really going to make things better.

But the student of economics must not neglect his books, especially the grand old standard books, which enable him to look at the ideas and movements of long ago with the eyes of the men who lived among them. And the first thing he will learn is that we are to-day looking at the evils of poverty in a new light. "We are all Socialists now," said Sir William Harcourt, and in a sense he was right. For we have almost to a man discarded the idea that social conditions are due to forces which the State could not control if it would, and should not attempt to control if it could. For one thing, we see quite clearly that State action in the past has contributed to produce the evils of to-day, and it is idle to protest against its action to-day in an amending direction. What is the State to do? To put the question frankly is the best way to get at the answer.

The reply of the Socialist is that the State must take over all the machinery of wealth-production. At present the worker is divorced

from all control of the system on which he depends. Through no fault of his own he may be unable to earn a living. Even now, in the throng of a boom in business such as we have not had for many years, many trade unionists in every thousand are out of work. Of a large majority of these it is clearly true that their misfortune, with all the suffering it often entails on a helpless wife and still more helpless children, is no fault of their own. When employed they work for an employer whose only motive for employing them is to make a profit on their work, and if he cannot do this he discharges them. As long as work is done for profit-seekers this is bound to happen. Moreover, even when at work their wages are determined by the same influences. The boss must have his profits, and his obvious plan is to keep wages as low as possible. Abolish the system of working for profits and wages, says the Socialist, and you abolish all the evils of the present system.

The Socialist thinks that the very forces of self-interest are tending to bring this about. For in all leading countries private firms are amalgamating into Trusts, and in extreme cases practically the whole of an important industry may be controlled by a small group of men. Carry the process a step further, he says, make the group into a State department, and the thing is done—to the obvious satisfaction of everybody.

Again the Socialist says that the older palliatives have failed. If the writer is asked whether that being so, it is true that all things point to Socialism, he could only reply that he does not know and does not care. For even if Socialism as a possible alternative to our present system had no drawbacks, it is perfectly certain that it has no chance of being adopted within any time that we can look forward to, and the writer is not interested in the affairs of 2500 A.D. Society is not divided

into two mutually exclusive and antagonistic classes, capitalists and workers, the exploiters and the exploited. If all the workers went on strike to-morrow to get the new system introduced (as the Syndicalists suggest doing to get their own brand of society set up) the people who would be the first and hardest hit by the strike would be the workers themselves. For by far the largest employers of the working classes are the working classes themselves, the capitalist being only an intermediary.

Society is too big and complex a thing to be fitted into the framework of any theory. As a working rule we must adopt the old maxim *Natura non facit saltum*. It is not without a deep meaning that Marshall has put his motto on the title page of his *Principles of Economics*, one of the weightiest, as it surely is one of the most human-hearted additions to our standard books. For Society is a natural growth, and it does not move of itself, and cannot be made to move from without, in leaps and bounds. It has had no respect for the trammels of individualism, and will have none for the aspirations of Socialism. It is big enough to need the best of both. The modern economist has no theoretical objections to State action. Here he is at one with the Socialist. Where he parts company is in insisting that State action is not an end in itself, but a means to an end, and that therefore its results must be measured and estimated as carefully as possible. If these short papers set a few readers to work to prepare themselves by reading, observing, and thinking, to play a better part in all kinds of available social action, they will have fulfilled the hope in which they have been written.

The Prime Minister

“Shorter hours, higher wages, a better standard of living for millions more men and women. That is the problem. Can we solve it? We can only solve it in one way, and that is by increasing production.”

Sheffield, October 16th, 1919.



The Rt. Hon. J. R. Clynes, M.P.

“Workmen who deliberately restricted output or who fail to accept any form of industrial development which would make their labour more productive were punishing themselves and their class without knowing it.”

Birmingham, August 13th, 1919.

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